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Supreme Court of the United States

OCTOBER TERM, 1957.

No. 304

IN THE MATTER OF CHERRY VALLEY HOMES, INC.,
Debtor,

UNITED STATES OF AMERICA,
Claimant-Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

JOSIAH E. DUBOIS, JR.,
Trustee of Cherry Valley Homes, Inc., Petitioner, Pro Se,
511 Cooper Street,
Camden, New Jersey.

I. J. Huntzinger Co., *Appellate Printers*, Camden, N. J.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner, JOSIAH E. DuBOIS, JR., TRUSTEE OF CHERRY VALLEY HOMES, INC., prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above entitled case.

REFERENCE TO OPINIONS BELOW.

The above entitled case was initially heard by a Referee in Bankruptcy for the United States District Court for the District of New Jersey, whose opinion is printed in Appendix "A" infra, at page 20. The oral conclusions of the United States District Court for the District of New Jersey are printed in Appendix "B", infra, at page 29, and the order of the said Court affirming the decision of the Referee is printed in Appendix "C", at page 34. The opinion of the United States Court of Appeals for the Third Circuit is printed in Appendix "D", infra, at page 35.

JURISDICTION.

The judgment of the United States Court of Appeals for the Third Circuit was entered on June 2, 1958, and is printed in Appendix "E", infra, at page 38. The jurisdiction of this Court is conferred by the Act of June 25, 1948, C. 646, 62 Stat. 928, 28 U. S. C. §1254 (1).

QUESTIONS PRESENTED.

Petitioner is Trustee of Cherry Valley Homes, Inc., a corporation which had filed a voluntary Petition for Reorganization under Chapter X of the Bankruptcy Act. Three subsidiary corporations of the debtor corporation were, prior to the filing of the Bankruptcy Petition, served with levies by the United States, on debts allegedly due

from these subsidiary corporations to another corporation, M. Tobin Co., Inc., which corporation was allegedly indebted to the United States for taxes. At the argument before the District Court, it was conceded by counsel for the United States that there was no indication that M. Tobin Co., Inc., was insolvent or that the United States was unable to collect its taxes from other assets of M. Tobin Co., Inc. The United States claims priority in the bankruptcy proceedings of Cherry Valley Homes, Inc. on the ground that the debts are "debts due the United States." The Referee and the District Court rejected the contention, and the United States Court of Appeals for the Third Circuit reversed their decisions. The fundamental question presented is whether the United States is limited to the rights that M. Tobin Co., Inc. would have had or whether it is entitled to priority. There do not appear to be any reported decisions on the exact question.

STATUTES INVOLVED.

The statutes principally involved, quoted in Appendix "F", are: Internal Revenue Code of 1954:

Sec. 6331 (26 U. S. C. 1952 ed., Supp. II, Sec. 6331).

Sec. 6332 (26 U. S. C. 1952 ed., Supp. II, Sec. 6332).

Revised Statutes, Sec. 3466 (31 U. S. C. 1952 ed., Sec. 191).

STATEMENT OF THE CASE.

On May 28, 1957, Cherry Valley Homes, Inc., filed a voluntary Petition for Reorganization under Chapter X of the Bankruptcy Act. A Plan of Reorganization was ap-

proved by the Referee and accepted on behalf of both secured and unsecured creditors; and was confirmed by the United States District Court on September 12, 1957. Under the Plan of Reorganization the percentage of their claims which unsecured creditors will receive in the ultimate distribution is not definitely fixed. They probably would receive in the neighborhood of 20% of their claims if the United States were not granted a priority. To the extent that the claims of the United States are entitled to priority, the unsecured creditors will receive less on account of their claims.

The present case concerns a claim of the United States for Internal Revenue taxes in the amount of $7473.50 plus interest from December 3, 1956 to the date of payment. The claim arises out of the fact that M. Tobin Co., Inc. is allegedly indebted to the United States for various tax claims in a sum in excess of $8000.00. The United States alleges that no part of these taxes has been paid. On December 3, 1956 the District Director of Internal Revenue in Philadelphia levied upon the following corporations as garnishees for the following amounts allegedly due from said garnishees to M. Tobin Co., Inc.:

(1) Anchorage Construction Co., garnishee, for levy served against M. Tobin Co., Inc., in the amount of $1139.00.

(2) Cherry Valley Builders, Inc., garnishee, for levy served against M. Tobin Co., Inc., in the amount of $3720.50.

(3) Delaware Valley Builders, Inc., garnishee, for levy served against M. Tobin Co., Inc., in the amount of $2614.00.

The basis of these garnishment proceedings arose out of the fact that said three corporations, namely Anchorage

Construction Co., Cherry Valley Builders, Inc., and Delaware Valley Builders, Inc., were allegedly indebted to M. Tobin Co., Inc., in the respective sums of $1139.00; $3720.50; and $2614.00; no part of which allegedly had been paid.

The Referee ruled generally that on the basis of the evidence presented at various hearings held before him, those creditors of Anchorage Construction Co., and Cherry Valley Builders, Inc., who could establish that they furnished materials or performed labor on the site of the Cherry Valley Homes development would, to that extent, be considered as creditors of Cherry Valley Homes, Inc.; and that the claims of said creditors would be recognized as claims against Cherry Valley Homes, Inc. This ruling by the Referee was on the basis of evidence which indicated that Anchorage Construction Co. and Cherry Valley Builders, Inc., were mere straw corporations working for the benefit of Cherry Valley Homes, Inc. No such evidence was produced at any of the hearings and there is no evidence in the record that Delaware Valley Builders, Inc., is such a straw corporation.

It should also be noted that the proof of claim filed by the United States does not establish, and the United States has offered no proof establishing, any of the following facts:

(a) That M. Tobin Co., Inc., was in fact indebted to the United States for the taxes allegedly due.

(b) That due notice and demand was made upon M. Tobin Co., Inc., to pay said taxes prior to the garnishment proceedings.

(c) That M. Tobin Co., Inc., neglected or refused to pay the same after due notice and demand.

(d) That a demand was made by the Secretary or his delegate upon Anchorage Construction Co., Cherry Valley Builders, Inc., or Delaware Valley Builders,

Inc., to pay the amounts levied upon to the Secretary or his delegate.

At the argument before the District Court it was conceded by counsel for the United States that there was no indication that M. Tobin Co., Inc., was insolvent or that the United States was unable to collect its taxes from other assets of M. Tobin Co., Inc.

The District Court affirmed the ruling of the Referee to the effect that the right of the United States to priority could rise no higher than the right of M. Tobin Co., Inc., to priority.

The United States Court of Appeals for the Third Circuit reversed the District Court, allowing the United States priority.

BASIS FOR FEDERAL JURISDICTION IN THE UNITED STATES DISTRICT COURT.

The basis for Federal jurisdiction in the United States District Court was the Bankruptcy Act.

REASONS FOR ALLOWANCE OF WRIT.

The decision of the United States Court of Appeals for The Third Circuit has granted the United States priority in the assets of Cherry Valley Homes, Inc., on the basis of taxes due the United States, not by Cherry Valley Homes, Inc., but by M. Tobin Co., Inc. The effect of the decision will be to require payment in full by the bankrupt corporation on account of the taxes due by M. Tobin Co., Inc.,

to the United States, at the expense of other general creditors of the bankrupt corporation. Had M. Tobin Co., Inc., paid its taxes to the United States and filed a Proof of Claim in the bankruptcy proceedings, it would have been a general creditor and would have received the normal dividend payable to general creditors.

Petitioner urges the allowance of the Writ because of the manifest injustice of such a result and for the following reasons based on the statutes involved:

I—The United States merely acquires a lien on the debt levied upon and said debt does not thereby become a "debt due to the United States" within the clear meaning of the language of R. S. §3466.

II—Public Policy demands that the language of R. S. §3466 should not be tortured to the extent of allowing priority to the United States on these facts.

III—The rights of the United States do not extend beyond those of the taxpayer whose rights are levied upon.

IV—The Circuit Court decision can have widespread harmful effects on the interests of both the Federal Government and citizens.

We now wish to present these reasons in further detail:

I. The United States merely acquires a lien on the debt levied upon and said debt does not thereby become a "debt due to the United States" within the clear meaning of the language of R. S. §3466.

This case, so far as counsel can ascertain after diligent research, is a case of first impression on this question.

Neither the Brief for the Government nor the Opinion of the Circuit Court of Appeals cite any case where the question was presented.

The cases relied upon in the Opinion of the Circuit Court fall into two groups. The first group are the cases cited to support the proposition that "this levy effectively and exclusively appropriated the debt to the satisfaction of the tax claim."[1] But these cases did not involve the question of priority of the United States under §3466, but rather the question whether the levy of the United States came ahead of or after the rights of other parties. Whether the levy made the debt a "debt due the United States" within the meaning of §3466 was not involved at all. Thus in *United States v. Liverpool & London & Globe Ins. Co.*,[2] the question was whether the lien of the United States was prior to that of an attachment creditor who had attached a debt in conjunction with the commencement of his suit. In *United States v. Eiland*,[3] the question was whether the lien of the United States on a debt owed the bankrupt was prior to the rights of the Trustee in Bankruptcy where the levy was made prior to bankruptcy. In *Kyle v. McGuirk*[4] the question was whether the United States could levy on an insurance policy of a bankrupt, where the beneficiary was his wife.

These decisions are completely consistent with the proposition that the United States, by a levy, secures a "lien" on the debt. This does not mean that the "debt" is thereby due to the United States. The language of the Opinion in

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[1] **United States v. Liverpool & London & Globe Ins. Co.**, 348 U. S. 215, (1955); **Kyle v. McGuirk**, 82 F. (2d) 212 (C. C. A. 3, 1936); **United States v. Eiland**, 223 F. (2d) 118 (C. C. A. 4, 1955).

[2] Supra note 1.

[3] Supra note 1.

[4] Supra note 1.

United States v. Eiland actually describes the claim of the United States as a "lien."[5]

There is a distinction between a "lien" and a "debt." A lien has been referred to as not being a debt but "a remedy for a debt."[6] And there are many cases making clear the difference between a "lien" and a "debt."[7]

The following example will clearly demonstrate that a levy made by the United States pursuant to the provisions of Sections 6331 and 6332 of the Internal Revenue Code does not create a "debt due to the United States" within the meaning of R. S. §3466. Assume the following facts:

> X owes the United States $5000 for taxes. A owes X $5000. B owes X $5000. A levy is made pursuant to the aforementioned sections of the Internal Revenue Code upon A for the full amount of the taxes due by X, namely $5000. A does not make payment of said $5000 to the United States, after demand by the Secretary. Then a levy is made by the United States upon B for the full amount of said taxes, namely $5000. B immediately makes payment to the United States. Is A still indebted to the United States for $5000?

The answer to the above is obvious and it is assumed will be conceded by the Government. A would not be indebted to the United States for $5000.

In other words, it is clear that the United States merely

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[5] "What we have is a perfected lien created by levy with respect to a specific indebtedness". (page 123).

[6] **Perry Coal Co. v. Richmond,** 4 N. E. (2d) 891 (Ill. 1936); **Aldrich v. Ederer Co.,** 134 N. E. 726 (Ill. 1922).

[7] **McIntire v. Garmeny,** 70 S. E. 198 (Ga. 1911); **Waldroup v. State,** 30 S. E. (2d) 896 (Ga. 1944); **Johnson v. City of Blackshear,** 27 S. E. (2d) 316 (Ga. 1943); **Conner v. Bender,** 125 F. (2d) 796 (C. C. A. 6, 1942); **United States v. Stokley Land & Livestock Co.,** 43 F. (2d) 366 (D. C. Wyo. 1930).

acquires a lien upon the indebtedness in question. The garnishee does not automatically become indebted to the United States within the true meaning of the word "debt" as normally used and within the meaning of "debt" as used in R. S. §3466.

The second group of cases cited in the opinion of the Circuit Court are those in support of the proposition that claims assigned to the United States are debts within the meaning of §3466.[9] These cases did not involve liens upon the debts, but full ownership of the debt. Thus, in *Wagner v. McDonald*,[9] the court appropriately stated:

> "Priority is the result of insolvency of the debtor and ownership of the claim by the United States * * *."

In the assignment cases cited by the Circuit Court, the United States owned the debt fully, and not as security for another debt. There never was an assignment here, and even had there been it would have been as security for the primary debt. Such an assignment would not be comparable to those in the cases cited where there was no other debt still in existence. In *Howe v. Sheppard*,[10] where there had been another debt, the primary debtor was released by the United States to the extent of the judgment assigned, thus giving the United States full ownership of the assigned judgment.

And even if it be said, as the Circuit Court opinion says, that there was an assignment by operation of law, this would not place the full ownership of the debt in the United

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[9] **Kerman v. Federal Housing Admr.**, 72 App D C 245, 113 F (2d) 743 (C A D C 1940); **Wagner v. McDonald**, 96 F (2d) 273 (C C A 8, 1938); **Howe v. Sheppard**, 12 Fed Cas 672 (C C D Me 1835); **In re Dickson's Estate**, 197 Wash 145, 84 P (2d) 661 (1938).

[9] Supra note 6.

[10] Supra note 8.

States in the sense in which it would be entitled to priority, for the primary debt of M. Tobin Co. still would exist.

The mere fact that §6332 of the Internal Revenue Code provides that any person who fails to surrender "property or rights to property, subject to levy" upon demand by the Secretary or his delegate "shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights to property" does not mean that a "debt" due to the United States" is thereby automatically created. Assume that the property upon which the "levy" is made is tangible property rather than a debt. The person holding the property is equally "liable" for the "value of the property." Yet it could hardly be contended that a "levy" upon tangible property or the demand to surrender such property would create a "debt." The "penalty for violation" provided by Section 6332 is an additional sanction for the enforcement of the lien, applicable alike to tangible or intangible property. If the person holding the property, whether tangible or intangible (such as a debt) did not surrender the same (by delivery or payment) to the Secretary and an appropriate action were then instituted in the Courts to fix and determine the liability provided for by the Statute, any unconditional judgment for a sum certain obtained thereby would undoubtedly be held to constitute a "debt due to the United States" within the meaning of R. S. §3466, but if the judgment were conditional in the sense that its validity depended upon the continued existence and nonpayment of another primary debt to the United States, we submit that such a judgment would not meet the requirements of R. S. §3466. In the instant case, however, the United States did not even pursue its lien to the point of obtaining a judgment.

II. Public policy demands that the language of R. S. §3466 should not be tortured to the extent of allowing priority to the United States on these facts.

The construction of the statutory provisions involved in the manner suggested in the brief of the United States and as adopted by the Circuit Court in its opinion promulgates a rule which violates public policy and, even without the clear language employed in said statutes, it is difficult to conceive that the Congress could have intended such a result.

There is no evidence in this case that M. Tobin Co., Inc., is insolvent. And the decision of the Circuit Court does not rest upon the insolvency of M. Tobin Co., Inc. Accordingly, solely from the standpoint of the equitable doctrine of the marshalling of assets, it would be most unfair and inequitable for the United States Government to collect the amount due it from M. Tobin Co., Inc., at the expense of the general creditors of Cherry Valley Homes, without first exhausting the possibility of collecting said monies from other assets of M. Tobin Co., Inc.

In addition, the construction of the statutes in question as made by the Circuit Court would lead to the following undesirable result. It would encourage a taxpayer who is owed money by a third party (said third party being unable to pay said debt and being on the verge of bankruptcy) not to pay taxes owed the United States and to attempt to induce the United States to levy upon the debt due from said third party. This would mean that:

(a) The taxpayer would be receiving payment in full out of the assets of the third party; whereas other general creditors might only receive a small percentage of their claims, if anything.

(b) The United States would become a collection agency for the taxpayer—a collection agency which could, for practical purposes, guarantee 100% collection for the small "fee" of accrued interest and penalties.

Applying the above to the case at bar, the result here of the adoption of the argument of the United States by the Circuit Court is that M. Tobin Co., Inc., will receive 100% payment on account of its general claim against Cherry Valley Homes, Inc.; whereas other general creditors will receive substantially less than 50% on account of their claims. M. Tobin Co., Inc., will thus benefit substantially because of its failure to pay its taxes to the United States; and will benefit at the expense of other general creditors, most of whom probably paid their taxes when due.

III. The rights of the United States do not extend beyond those of the taxpayer whose property is levied upon.

This fundamental principle is found in many decisions in the United States Courts, and in these opinions the equities and natural justice are given great weight.

The United States Supreme Court, in *United States v. Kaufman*, 267 U. S. 408 (1924), rejected the contention of the United States that under §3466 it was entitled to priority out of partnership assets for taxes due from a partner. The Court held that the priority of the United States was limited to the share of the partner in the partnership assets.[11]

Other instances of the rejection by the Courts of inequi-

[11] The Court said (p. 413):

"These decisions are directly applicable to §3466 of the Revised Statutes—on which the United States relies—which incorporated the provisions of the Act of 1799 and similar Acts of August 4, 1790, and March 3, 1797, in the general provision that whenever any person

table priorities to the United States in similar situations are the following:

(1) *United States v. Winnett*, 165 F. (2d) 149 (C. C. A. 9, 1947). W gave a note to S for $60,000 and later endorsed notes for S with the agreement that if W had to pay the endorsed notes, he could set them off against the $60,000 note. After Federal tax liens were filed against S, and a levy against W, W had to pay some endorsed notes. The United States claimed the entire $60,000 but the Court rejected the contention on the ground that the Collector could not reach anything Summers could not have reached, and the equities in the case were clearly with Winnett.[12] Therefore, the setoff, although arising after the tax levy, was allowed.

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indebted to the United States is insolvent, the debts due to the United States shall be first satisfied, and that this priority shall extend to cases in which an act of bankruptcy is committed. And in so far as this section, under the rule stated in Guarantee Co. v. Title Guaranty Co., 224 U. S. 152, may now be applicable in bankruptcy proceedings, it must be held that any priority of payment to which the United States is entitled for a debt due it from an individual partner, extends only to his share in the surplus of the partnership assets."

[12] The Court said (p. 151):

"Appellant's main contentions are: That since Winnett's right to offset was a contingent right on February 16, 1939, the date of the lien secured by the United States, and since no offset had been made or could be made on that date, its tax lien attached to the entire $60,000 note, and that apart from its lien, the United States had a priority in the property of Summers upon her insolvency under §3466, R. S., 31 U. S. C. A. §191, and that this priority precluded any subsequent setoff. We do not agree . . .

"'Indeed, natural justice would seem to require that where the transaction is such as to raise the presumption of an agreement for a set-off, it should be held that the equity that this should be done is superior to any subsequent equity not arising out of a purchase for value without notice.' This is so in the face of a claim of the United States based on §§3710 (a) and 3672 of the Internal Revenue Code, or §3466 of the Revised Statutes. The Collector can reach nothing that Summers could not have reached. The equities in this case are clearly with Winnett. He should not be required to pay the same debt twice even though the interposition here is by the sovereign."

(2) *Karno-Smith Co. v. Maloney*, 112 F. (2d) 690 (C. C. A. 3, 1949).

General contractor who owed subcontractor on the contract, was obligated by bond for the payment of all materials. The subcontractor failed to pay for some materials, and the general contractor was called on to pay it out of the moneys due subcontractor. A Federal tax lien was later filed against the subcontractor. The Court rejected the contention of the United States that it was entitled to payment on the ground that the equities were clearly with the plaintiff, who was obligated under his bond for the materials and also to the subcontractor on the contract. The enforcement of both obligations would be "manifestly inequitable," the Court said.[13]

(3) *F. H. McGraw & Co. v. Sherman Plastering Co.*, 60 F. Supp. 504 (D. C. Conn. 1943), affirmed 149 F. (2d) 301 (C. C. A. 2, 1945), cert. den. 326 U. S. 753, 66 S. Ct. 92, 90 L. Ed. 452 (1945).

Subcontractor owed his materialmen more than was due him from general contractor. The Court rejected the contention of the United States for priority payment for taxes of subcontractor out of the amount due from general contractor. The Court held the failure

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[13] The Court said (p. 692):

"We think the equities of the case are clearly with the plaintiff. It finds itself in a dilemma forced upon it by the law. Under its contract it is obligated to its subcontractor and under its bond it must pay the latter's unpaid debt to the materialman. The two obligations arise out of the same transaction, but payment of the subcontractor's taxes pursuant to the collector's levy and demand will not and cannot discharge the obligation to the subcontractor's materialman which the statutory bond imposes upon the plaintiff. Under these circumstances it would be manifestly inequitable to enforce both obligations . . . We think it is clear that in a case of this kind the rights of the collector rise no higher than those of the taxpayer whose right to property is sought to be levied upon . . ."

of the subcontractor to pay his materialmen was available to general contractor as a defense pro tanto, or by way of recoupment.

(4) *Bankers Title and Abstract Co. v. Ferber Co.*, 15 N. J. 433 (1954).

Tax lien of Federal Government against subcontractor held no greater than right of subcontractor to contract funds, and subcontractor's materialmen, who filed stop notices before distribution of contract funds, had priority over federal tax lien."

Applying the principles of these cases to the case at bar, the rights of the United States can rise no higher than the rights of the taxpayer whose right to property was levied upon. M. Tobin Co.'s right was unquestionably a right to payment as a general creditor, and the rights of the United States should be the same.

The decision of the Circuit Court in the instant case violates this fundamental principle. Under the decision of the Circuit Court, the United States acquires greater rights than those to which Tobin, the taxpayer in default, would have been entitled if the United States had not levied upon his rights. The gross inequity of such a result is not only apparent but is clearly recognized by the foregoing decisions.

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[14] The Court said (p. 441):

"In the present case the United States has a lien, if at all, on only the funds to which the subcontractor, Zaro, may be entitled. The federal lien attaches only to the property of Zaro. The ruling principle in this respect, expressed in the federal courts, is that the rights of the United States (i. e., the Collector of Internal Revenue or his counterpart) do not extend beyond those of the taxpayer whose right to property is sought to be levied on."

IV. The Circuit Court decision can have widespread harmful effects on the interests of both the Federal Government and citizens.

This case can not be properly evaluated without considering what the effect of the decision of the Circuit Court will be in the future insofar as the interests of the Federal Government and the interests of the average citizen are concerned.

During the last fiscal year, more than 90,000 Petitions in Bankruptcy were filed throughout the United States. In addition, of course, there were innumerable businesses on the verge of bankruptcy or in financial difficulty.

The Circuit Court decision, in effect, says that if John Jones is a creditor of a business which he has reason to believe is in shaky financial condition, John Jones may be able to obtain preference over other creditors and may be able to use the United States Government as a collection agency by resorting to the simple device of not paying his taxes to the United States Government. It can be anticipated that if the decision of the Circuit Court becomes widely known in the business world, resort to this device will be attempted, perhaps successfully, by many thousands of creditors.

It is not an answer to state, as the Circuit Court stated, that in this particular case, there was no evidence that Cherry Valley was insolvent when the levy was made upon the debt it owed to Tobin. It is well known that proof of the exact time that a particular business concern becomes insolvent is difficult to establish in most cases. The important point here is that any creditor who has not been paid by his debtor and who believes that the debtor is in a shaky financial condition, even though from the standpoint of legal proof it may not be possible to establish that the debtor is insolvent, will be encouraged to attempt to obtain

100% payment of his claim by not paying his taxes to the United States Government and informing the Internal Revenue of the existence of the debt owed to him by the debtor.

As pointed out by the Judge of the District Court, there is absolutely no evidence here that Tobin was insolvent and unable to pay its taxes to the United States Government. Nor is there any evidence that the United States could not have collected its claim by resort to other assets of Tobin, aside from the claim of Tobin against Cherry Valley. The actions of the United States Government in levying upon the claim of Tobin against Cherry Valley and not upon other assets of Tobin, and then attempting to collect in full from the assets of the bankrupt Cherry Valley, most clearly produces injustice; quite apart from the fact that such a practice is not, in the long run, in the financial interest of the United States.

It is inconceivable that the United States Government, representative of all the people, should be put in the position where it can, in effect, be used by one citizen to gain undue and unfair advantages over other citizens.

CONCLUSION.

Accordingly, it is submitted that the petition for the Writ of Certiorari should be allowed for the following reasons:

(a) The United States merely acquired a lien on the debts allegedly due from Anchorage Construction Co., Cherry Valley Builders, Inc., and Delaware Valley Builders, Inc., and the alleged debts of said corporations to M. Tobin Co., Inc., did not (as a result of the levies made) become "debts due to the United States"

within the clear meaning of the language of R. S. §3466.

(b) The construction of R. S. §3466 in the manner suggested in the brief of the United States, and as adopted by the Circuit Court, does violence to the language of said statute, and creates a result which is contrary to public policy.

(c) The rights of the United States do not extend beyond those of the taxpayer whose property is levied upon.

(d) The Circuit Court decision can have widespread harmful effects on the interest of both the Federal Government and citizens.

JOSIAH E. DuBOIS, JR.,
Trustee of Cherry Valley Homes, Inc., Petitioner, Pro Se.

APPENDIX.

A. Certificate of Review by Referee.

I, William Lipkin, one of the Referees in Bankruptcy for the United States District Court, District of New Jersey, to whom the above entitled matter has been referred, certify that the following is the record and order of the Referee, relating to denial by me of a status of priority of a claim of the United States of America against the assets of the debtor corporation.

The above estate was referred to me by an order of your Honor on May 25, 1957. This estate commenced upon petition by the debtor corporation for reorganization. The debtor's name is as above, to wit, Cherry Valley Homes, Inc., a corporation of the State of New Jersey.

I respectfully submit the following background facts leading up to the Petition for Review filed by the government:

Hearings before me disclosed that the debtor corporation was the owner of homes in Delaware Township, and land, in Delaware Township, which was being developed, but that the liabilities for such development were incurred by three separate corporations. The stockholders and directors of all four corporations were the same individuals. The names of the other three corporations were K.E.C. Associates, Anchorage Construction Co., and Cherry Valley Builders, Inc. The three individuals who owned all the stock in the corporations were Kensil, Engel, and Cummings.

The debtor disputed all claims against the debtor estate, but after hearings I determined that the debtor corporation was responsible to pay the debts incurred by the three corporations for materials supplied and work performed upon

the homes and land sites of Cherry Valley Homes, Inc., and that all of such creditors could file claims against the debtor estate and vote to accept or oppose the plan of reorganization.

As a result of hearings on the plan, the requisite amount of creditors affected by the plan voted to accept the plan after I had approved of the plan. The matter came on for hearing before your Honor on September 12, 1957, upon notice to all parties, for confirmation of the plan, and the plan was confirmed by your Honor.

The plan called for assumption of certain mortgages and payment of $40,000 to the Trustee by one Bernard Weinberg, for all the land and homes under construction. In addition, the Trustee is in the process of gathering in certain other assets so that it is not possible to say at this time how much will be available for unsecured creditors after payment of prior and administrative claims.

However, it appears that the $40 000 is more than enough to take care of any prior, including any taxes allowed or to be allowed as a prior claim, and administrative claims.

The United States Government claimed that it has a right to have all its claims treated as prior claims and so represented to me at the time when I called for votes upon the plan of reorganization, which plan calls for payment in full of prior claims.

In considering the claims at that time I declared orally from the bench that I did not deem it necessary to consider the government's claims in computing the acceptances, as the plan called for payment of all prior claims and, therefore, its rights were not affected by the plan.

The attorney for the United States, however, requested a ruling as to the status to be attached to certain of its claims against the debtor estate. I then determined that certain of its claims were not entitled to priority but only would share as to such claims in the assets on a parity with unsecured creditors.

More particularly, with respect to the claims filed by the United States, they total five in number. The priority of the first three was not disputed, but the Trustee may question the amount thereof at a later date.

The first three are as follows:

One, "Cherry Valley Homes, Inc., and/or K.E.C. Associates, a close affiliate or subsidiary of Cherry Valley Homes, Inc.," in the sum of $852.68.

Number two is "Cherry Valley Homes, Inc., and/or Cherry Valley Builders, Inc., a close affiliate or subsidiary or Cherry Valley Homes, Inc.," in the sum of $137.10.

Number three is "Cherry Valley Homes, Inc., and/or Anchorage Construction Co., a close affiliate or subsidiary of Cherry Valley Homes, Inc.," in the sum of $3007.62.

These three claims are against corporations which performed work on the debtor's assets and which I determined were in reality only "Straw" corporations without assets, and worked for the benefit of the debtor corporation. In equity and good conscience, and consistent with my determinations as to all such claims, I held them to be debts of the debtor corporation. As such they would be entitled to be treated as prior claims and to be paid before unsecured claims. Title 31, U. S. C., 191 R. S. 3466. The total of such claims is $3997.40, with interest, from September 3, 1957. (Claims are attached hereto and marked Exhibits 1, 2, and 3, for Review, respectively.)

However, the United States Government filed a claim against "Cherry Valley Homes, Inc., and/or Delaware Valley Builders, Inc., a close affiliate or subsidiary of Cherry Valley Homes, Inc.," in the sum of $1137.43. At no time during the course of the hearings when the officers of the corporation testified, nor from the report of the accountant appointed by me to review and audit the books of the debtor corporation, was it disclosed that a corporation by the name of Delaware Valley Builders, Inc., supplied materials or

labor to the building development of the debtor corporation. The accountant's report only indicates that a firm by the name of Delaware Valley Builders is indebted to the debtor corporation in the sum of $2200. (Accountant's report is attached hereto, marked Exhibit No. 4, (Schedule A-1 thereof.)) The Trustee as of this time has not developed by any hearings before me the nature of this indebtedness.

Therefore, in the absence of any proof or testimony to show that Cherry Valley Homes, Inc., the debtor corporation, is responsible in any way for the debts of Delaware Valley Homes, Inc., I did not consider it necessary to consider such claim in the computation of claims. In any event, if facts are produced at a hearing, when the issue of the validity of the claims is to be determined, which would establish the claim to be one of the debtor corporation, then sufficient funds are available to pay the claim as a prior claim. (This claim is attached hereto and marked Exhibit No. 5 for Review.)

It is therefore respectfully submitted that the Petition for Review actually concerns the last proof of claim filed by the United States. This claim is attached hereto and marked Exhibit No. 6 for Review. The Petition for Review is attached hereto and marked Exhibit No. 7 for Review.

The claim (Exhibit No. 6) is addressed against Cherry Valley Homes, Inc., a corporation of the State of New Jersey and/or Anchorage Construction Co. and/or Cherry Valley Builders, Inc., and or Delaware Valley Builders, Inc., subsidiaries or closely related corporations. The claim is in the sum of $7473.50, plus interest from December 3, 1956.

The claim itself is then broken down into three separate items against each of the last three above named corporations as garnishee under a levy served against M. Tobin Co., Inc.

The facts stated to the Court were that M. Tobin Co., Inc. was indebted to the United States Government in a sum in excess of $8,000 for various tax claims.

It made a levy upon Anchorage Construction Co., Cherry Valley Builders, Inc., and Delaware Valley Builders, Inc., for debts due by such corporations to M. Tobin Co., Inc. The total of such sums, according to the proof of claim, is $7473.50. The breakdown in the proof of claim alleges the debt from Anchorage Construction Co. to be $1139; Cherry Valley Builders, Inc., to be $3720.50; and Delaware Valley Builders, Inc., to be $2614.

Here again with reference to the last item alleged to be due from Delaware Valley Builders, Inc., to M. Tobin Co., Inc., no proof has been offered before me, and in fact at the present time the contrary appears to be the situation, that Delaware Valley Builders, Inc., is not the alter ego of the debtor corporation, or that the debtor corporation should be charged with the debts of Delaware Valley Builders, Inc.

However, I decided that as to all debts due M. Tobin Co., Inc. which were levied upon, the Government's right for payment did not rise any higher than the right of M. Tobin Co., Inc., and the only priority that possibly existed as to such debts was that the United States Government would be entitled to payment of such sum as would ultimately be payable to M. Tobin Co., Inc. to the exclusion of other creditors of M. Tobin Co., Inc. I denied the right of the Government to payment in full as a prior claim of a general unsecured claim of M. Tobin Co., Inc. because of the levy made on such indebtedness prior to the commencement of these proceedings.

The Government has asserted its right to priority of payment under the provisions of R. S. Section 3466, Title 31, U. S. C. 191. This section is as follows:

> "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased

the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

In deciding the question presented by the Government I recognized that Section 64 of the Bankruptcy Act, dealing with priority of debts, was not controlling in Chapter X proceedings. In re Sixty Seven Wall Street Restaurant Corporation (DCNY 1938) 23 Fed. Supp. 672; U. S. vs. Emory, 314 U. S. 423 (1941). I further recognized that under the provisions of Section 199 of the Bankruptcy Act, dealing with Chapter X proceedings, that no plan can be confirmed by the judge which does not provide for payment of a Government claim for taxes or customs duties of a debtor. Debtor is defined in Section 106 of the Bankruptcy Act as "a corporation by or against which a petition has been filed under this Chapter".

It was my determination that the tax levy was against the taxpayer, M. Tobin Co., Inc. The debtor, M. Tobin Co., Inc., is not the debtor in the reorganization proceedings. M. Tobin Co., Inc., is only a general unsecured creditor of the corporation now being reorganized. If the levy by the Government had not been made upon such debt, M. Tobin Co., Inc. would share pro-rata with other unsecured creditors of the Cherry Valley Homes, Inc., in the assets available for unsecured creditors. It is quite clear that such payment will not pay the debt in full. However, if the Government's contention of priority was allowed, it would enable the creditor, through the action of the Government, to secure payment far in excess of the other unsecured creditors.

It was my determination that R. S. Sec. 3466, Title 31, U. S. C. 191, set forth above, was not applicable to the debt for which priority of payment was sought. I held that at best the Government would have a right to receive from the Trustee the distributive share due M. Tobin Co., Inc. ahead of any other creditors of M. Tobin Co., Inc.

In all the cases considered by me whereby the Government was entitled to priority of payment under the provisions of Section 3466, Title 31, U. S. C. 191, they involved instances where the Government advanced money or guaranteed obligations of the debtor. In such cases the debtor either incurred the debt to the Government or secured the benefit of funds under an overt act whereby the Government became obliged to make payment to a third party, and the claim was assigned to the Government. Lewis, Trustee, vs. U. S., 92 U. S. 618 (S. Ct. 1875) where the bankrupt partnership and its members were liable for funds entrusted by the Navy; U. S. vs. Fisher, 2 Crouch 358, 6 U. S. 358 (1805); U. S. vs. Eiland, 223 F. 2d 118 (4 Cir. 1955). In the Eiland case the debtor, Boone County Coal Company, was solvent, and the creditors, Sport Coal Company, was the bankrupt. The Government levied for taxes owing by Sport Coal Company upon a debt due it by Boone County Coal Company. The levy was made prior to bankruptcy of Sport Coal Company. The Court allowed the claim of the Government to such fund as against the Trustee of the Sport Coal Company. In the case before me the debtor is insolvent, and the creditor (M. Tobin Co., Inc.) may or may not be insolvent. I held that the Eiland case was not applicable to the issue before me.

I decided that the issue of priority may be decided in Chapter X proceedings by the Bankruptcy Court as set forth in Raffaele et al. vs. Granger (3 Cir. 1952 J. Hastie) 196 F. 2d 620.

Furthermore, I was mindful of the cases which state that

priority of payment under the provisions of Section 3466 is statutory and where all factors required in the statute are not present, then the Government's claim of priority fails. United States Fidelity & Guaranty Co. vs. Porter, 3 F. 2d 57 (D. C. Idaho 1924). The Court said, page 62,

> "It is to be borne in mind that the right asserted by plaintiff is strictly legal; it does not rest upon broad principles of equity, but runs counter thereto. In equity all depositors are on the same footing, and whether strong or weak, rich or poor, each is entitled to a ratable distribution of the assets of the bank without preference of kind to anyone. Plaintiff's right, if one it has, is a creature of statutory law, and as I read the decisions of the Supreme Court, it exists only in a case where the facts fall strictly within the provisions of the statute from which it springs."

U. S. v. City of Greenville, 118 F. 2d 963 (4 Cir. 1941).

Furthermore, as set forth in In re Sixty Seven Wall Street Restaurant Corporation (D. C. N. Y. 1938), 23 Fed. Supp. 672; the Court has the discretion to classify claims and to grant preference as the facts of the particular case may require. Section 197 of Bankruptcy Act.

The Government in its argument before me relied heavily upon cases which arose out of Federal Housing Administration guaranteed loans which were in default prior to bankruptcy and which were paid by the Government and which then were assigned to it. Corning vs. F. H. A., 113 F. 2d 743; Wagner vs. McDonald, F. H. A. Administrator, 92 F. 2d 273 (9 Cir. 1938).

However, where the debt is assigned after bankruptcy then the Government is not entitled to priority of payment. Matter of Hansen Bakeries, Inc. (3 Cir.), 403 F. 2d 665; Federal Housing Administrator vs. Moore (9 Cir.) 90 F. 2d 32.

In making my determination that the Government was not a creditor entitled to priority of payment in full from the Trustee, I considered that the debt due by the debtor corporation to M. Tobin Co., Inc. bore no relationship to the debt due by M. Tobin Co., Inc. to the Government on its tax liability. The tax debt due by M. Tobin Co., Inc. was far in excess of the debt due to M. Tobin Co., Inc. I recognized that the debt due by the debtor to M. Tobin Co., Inc. could be levied upon by the Government but what that debt would be in dollars and cents depended upon what sum would have been payable to M. Tobin Co., Inc. by the Trustee after confirmation of the plan or upon liquidation in the event of bankruptcy of the debtor corporation.

I stated, in denying the application of the Government for priority, that Section 3466 was not applicable under the facts before me, and to decide otherwise could very well lead to a practice by creditors of "financially shaky" debtors, which creditors cannot secure preferential payment of liens within four months of bankruptcy, under the Bankruptcy Act, and which creditors are indebted to the United States Government for taxes or other obligations to assign their claims to the Director of Internal Revenue or other governmental agency or invite a levy to be made upon the debt due them whereby payment would be made in full of such indebtedness at the expense of all other creditors of the debtor or bankrupt, and in turn their tax liability or indebtedness to the Government reduced. I determined that I could find no reason and had no right to extend the provisions of Section R. S. 3466, Title 31, U. S. C. 191 to permit such action whereby M. Tobin Co., Inc. would receive a credit of over $7,000 upon its tax liability, though it was only a general unsecured creditor of the debtor corporation.

The debt was not one that had been created by the debtor in favor of the Government, nor had the Government ever been a party to the dealings between M. Tobin Co., Inc.

and the debtor corporation, which gave rise to the indebtedness.

Respectfully submitted,

WILLIAM LIPKIN,
Referee.

Dated: —— —, ——.

B. ORAL COMMENTS AND CONCLUSIONS OF UNITED STATES DISTRICT COURT.

The above matter came on for argument before the Honorable THOMAS M. MADDEN, U. S. D. J. at the courtroom of the United States District Court, Post Office Building, Camden, New Jersey on December 20, 1957, at 10:00 o'clock a. m., local time.

APPEARANCES:

For Trustee—Pro Se.

For Government—JOHN H. MOHRFELD, III, Esq. and DAVID CRABTREE, Esq.

* * * * * * * * * *

(3) THE COURT: Do you have any cases right on point?

MR. CRABTREE: No, sir, your Honor. As I understand it this is a case of first impression. We rely upon the language used by Judge Parker in the case of the United States v. Eiland, a 4th Circuit decision, decided in 1955, and reported in 223 F. 2d, which involved the bankruptcy in that particular case of the taxpayer, unlike the situation here. In that case ——

THE COURT: Completely unlike the situation here.

MR. CRABTREE: It is our position that the legal principles are precisely the same regardless of the change in facts.

THE COURT: Can you say that the adoption by (4) the court or any court of your position would not possibly lead to great fraud.

MR. CRABTREE: As a possibility, your Honor, of course, that is true.

THE COURT: Well, isn't it better than just a possibility. Didn't the Referee very capably point out that if I am a creditor of a certain corporation, and any corporation today, especially in these matters, is constantly indebted to the Government for the withholding taxes that it is taking in, and for which they have to remit only at stated intervals, so that we can work on the assumption that every corporation is constantly indebted to the Government, and if I am a corporation and I have money owed to me by B corporation, and I begin to become concerned about the financial standing of B corporation, I realize that if B corporation becomes bankrupt, I may get a very small dividend. I also realize that I can beat all the other creditors in a legal way, that I can do it legally by an assignment of my debt against the B corporation to the Government. If any court would subscribe to that theory, the Government would have priority over all other creditors. It would stand in a better position (5) than the assignor of the debt.

MR. CRABTREE: Your Honor, let me put it this way

THE COURT: Wouldn't that be the effect of it, Mr. Crabtree?

MR. CRABTREE: I don't deny that, your Honor. However, let me say this: Of course, it is presumptuous to say that each case must be decided on its own facts. We submit the particular situation your Honor posed in your hypothetical argument must have been present when it arose. The solitary fact remains that such a situation did not obtain in this case. The fact remains ——

THE COURT: Wait a minute. What do we have to show that it doesn't obtain? Is Tobin your original debtor?

MR. CRABTREE: It is the taxpayer.

THE COURT: Your original debtor is he still solvent?

MR. CRABTREE: I have no way of knowing.

THE COURT: So, therefore, you can't represent to the court that this did not occur.

MR. CRABTREE: If your Honor please, that would be a matter of proof. That particular legal (6) question involved here has been disposed of. If it should devolve upon the Government, if the Government is permitted to prove the facts surrounding its claim when the matter is remanded to the Referee, then, we submit, your Honor, the possibility, I should say, of the presence of fraud in this particular case, is a matter which must be proved at that time.

We are arguing, your Honor, for the application of a legal principle based upon the concept that a levy upon a debt owed the taxpayer has the effect of transferring that indebtedness to the United States.

THE COURT: You want to go further. You don't want

merely to transfer the debt. You want to transfer the debt together with the attaining of a priority for the debt.

MR. CRABTREE: Well, your Honor, that is a necessary and inescapable conclusion from your concept of transfer as the Circuit Courts have pointed out in the cases I have cited in our brief. For example, in the Beaston case:

"All debtors to the United States, whatever their character, and by whatever mode bound, may be fairly included within the meaning of the language (7) used . . ."

THE COURT: This isn't basically a debt to the United States. You are getting it by legal assignment.

MR. CRABTREE: Yes, sir, and we submit ——

THE COURT: The assignee never gets any more than the assignor can give him, and the assignor here cannot give you priority.

. . . . . .

(12) THE COURT: Let me ask you this: Isn't the bankruptcy law the equity arm of the court?

MR. CRABTREE: Yes, sir.

THE COURT: Now, what equity is it to allow a situation whereby Tobin gets his debt paid to the Government out of funds that are due to A, B, C, and D, common creditors of Cherry Valley? Tobin then goes scot free because his debt is paid, and the Government would become an agent for Tobin to collect his debt without making any visible promise to see if it can get any additional money out of Tobin for this eight thousand dollars that he owed

the Government, and which we took out of the bankrupt proceeds over here, and we will take whatever we can get from Tobin, and if we get it in full, we will put this—pay this money back to these creditors. You don't take that position, do you?

MR. CRABTREE: No, your Honor.

THE COURT: And rightly so because the Government should not be a collecting agent for somebody (13) else, and that is exactly what they are doing in this case, or attempting to do, and that, likewise, is against public policy.

(14) THE COURT: Let me ask you this: Did you for the United States ever make any application to the Referee to show the financial position or condition of Tobin or your inability to collect from Tobin by selling him out?

MR. CRABTREE: No, your Honor, we did not.

MADDEN, U. S. D. J.:

The court will recognize the necessary public policy that when the Government has a debt against a bankrupt estate, the Government has priority for its lien and its debt, but the court feels that to attempt to apply the theory advanced by the Government in this particular matter would be contrary to public policy, and would possibly lead to the commission of fraud, and make the Government a party to such fraud against the creditors of bankrupt estates.

With no precedent to establish such a theory, this court is not going to establish it.

Mr. Crabtree, I make the suggestion to you if you feel firmly about this, you get it established by the Court of Appeals.

MR. CRABTREE: Yes, sir, we will.

THE COURT: If they see fit to do it then, naturally, that will be the law.

You will submit an order, gentlemen, that the order of the referee will be upheld.

I HEREBY CERTIFY that the above is a true and correct transcript of the oral conclusions arrived at in the above-entitled matter on December 20, 1957.

CHARLES J. DEGNAN,
United States Court Reporter.

C. ORDER AFFIRMING RULING OF THE REFEREE.

At Camden, New Jersey, in said district on the 23rd day of December, 1957.

The United States having filed a claim based on levies served pursuant to sections 6331 and 6332 of the Internal Revenue Code of 1954 upon Anchorage Construction Company, Cherry Valley Builders, Inc., and Delaware Valley Builders, Inc., prior to the commencement of this proceeding.

Said levies having been served on Anchorage Construction Company, Cherry Valley Builders, Inc., and Delaware Valley Builders, Inc., which at the time were indebted to the M. Tobin Company of Philadelphia, Pennsylvania, in the amount of $7473.50.

The aforesaid claim filed by the United States having asserted priority under the provisions of R. S. 3466, Title 31 U. S. C. §191.

The Referee having disallowed this claim as a priority claim and having limited the rights of the United States therein to those of the M. Tobin Company.

This Court having received briefs and heard arguments from the United States and the Trustee relating to the decision of the Referee and this Court being satisfied that the rights of the United States should be limited to the rights of the M. Tobin Company;

IT IS HEREBY ORDERED AND ADJUDGED that the decision of the Referee is hereby affirmed in all respects.

(S.) THOMAS M. MADDEN,
Judge, United States District Court
District of New Jersey.

I hereby consent to the form of the above order.
(S.) JOHN H. MOHRFELD 3,
United States Attorney.

D. OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

HASTIE, *Circuit Judge.*

The disputed question here is whether the United States is entitled to have a certain claim paid out of the assets of Cherry Valley Homes, a corporation in reorganization under Chapter X of the Bankruptcy Act, 11 U. S. C. §§501-676 before provision is made for the claims of general creditors. The referee in bankruptcy and the district court denied the claim of priority, and the government has appealed.

Cherry Valley Homes, Inc., hereinafter "Cherry Valley", owed M. Tobin Co., hereinafter "Tobin", a liquidated sum of approximately $7000 which was less than the amount of a tax claim which the United States had asserted with all prescribed formality against Tobin. In levying for taxes upon Tobin's property, the government had served appropriate process on Cherry Valley.[1] There is no suggestion that the notice to or demand upon this debtor was in any way inadequate as a levy upon the debt it owed Tobin. On the record we have a perfected levy upon specific incorporeal property of a taxpayer, namely, a liquidated sum owed Tobin by Cherry Valley. This levy occurred December 3, 1956. Cherry Valley did not file its voluntary petition for reorganization until May 28, 1957.

In legal contemplation and consequence, this levy effectively and exclusively appropriated the debt to the satisfaction of the tax claim six months before the Chapter X proceeding was instituted. *United States v. Liverpool & London & Globe Ins. Co.*, 1955, 348 U. S. 215; *Kyle v. McGuirk*, 3d Cir. 1936, 82 F. 2d 212; *United States v. Eiland*, 4th Cir. 1955, 223 F. 2d 118. Such a levy is treated in law like a seizure of corporeal property, taken into the possession of a collector by way of distraint for taxes. See *Freeman v. Mayer*, 3d Cir. 1958, 253 F. 2d 295, 298; 26 U. S. C. §§ 6331, 6332. Appellant recognizes that such a levy at least makes the government a lienor, with a perfected right to have the entire debt paid to it. By whatever name the appropriation shall be called, it seems clearly sufficient to establish a priority of right to satisfaction which the debtor's subsequent insolvency does not affect.

Alternatively, as the government urges here, since the

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[1] Actually, three wholly owned subsidiaries of Cherry Valley were served, but the referee and the district court have treated Cherry Valley as the real party concerned and affected.

possessory concept of "seizure" is not strictly applicable to a debt, it seems correct to say that the tax levy through process served upon the debtor at least accomplished an assignment of Tobin's claim against Cherry Valley to the United States by operation of law. This approach brings into decisive effect the provision of Revised Statutes, Section 3466, 31 U. S. C. 191, that "whenever any person indebted to the United States is insolvent . . . the debts due to the United States shall be first satisfied." This language has been applied to claims, originally between private parties, the benefit of which has in various ways been assigned or transferred to the United States. *Korman v. Federal Housing Admr.*, D. C. Cir. 1940, 72 App. D. C. 245, 113 F. 2d 743; *Wagner v. McDonald*, 8th Cir. 1938, 96 F. 2d 273; *Howe v. Sheppard*, C. C. D. Me. 1835, 12 Fed. Cas. 672; *In re Dickson's Estate*, 1938, 197 Wash. 145, 84 P. 2d 661. We think it applies here as well.

Finally, it is argued in a general way that there is some lack of equity in the priority thus accorded the government. But we see no inequity in recognizing that the government acquired a priority over general creditors when its claim was asserted and perfected against the debt owed by Cherry Valley many months before Chapter X proceedings were instituted. To make the argument of inequity even colorable, though not necessarily sound, it would have to appear that Cherry Valley was insolvent when the levy was made upon the debt it owed. And nothing of the sort appears in this record.

The judgment will be reversed.

E. JUDGMENT OF UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby reversed.

Attest:

IDA O. CRESKOFF,
Clerk.

June 2, 1958.

F. STATUTES INVOLVED.

Internal Revenue Code of 1954:

Sec. 6331. *Levy and Distraint.*

(a) *Authority of Secretary or Delegate.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d) of such officer, employee, or elected official. If the

Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

(b) *Seizure and sale of property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

(c) *Successive seizures.* Whenever any property or right to property upon which levy has been made by virtue of subsection (a) is not sufficient to satisfy the claim of the United States for which levy is made, the Secretary or his delegate may, thereafter, and as often as may be necessary, proceed to levy in like manner upon any other property liable to levy of the person against whom such claim exists, until the amount due from him, together with all expenses, is fully paid." (26 U. S. C. 1952 ed., Supp. II, Sec. 6331.)

"Sec. 6332. *Surrender of Property Subject to Levy.*

(a) *Requirement.* Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for Violation.*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy.

* * * * * * * * *

(26 U. S. C. 1952 ed., Supp. II, Sec. 6332.)

Revised Statutes:

Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(31 U. S. C. 1952 ed., Sec. 191.)

ILE COPY

FILED
SEP 24 1958
JAMES R. BROWNING, Clerk

No. 304

In the Supreme Court of the United States

OCTOBER TERM, 1958

JOSIAH E. DU BOIS, JR., TRUSTEE OF CHERRY VALLEY HOMES, INC., PETITIONER,

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 304

JOSIAH E. DU BOIS, JR., TRUSTEE OF CHERRY VALLEY HOMES, INC., PETITIONER,

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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OPINIONS BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (Pet. 35-37) is reported at 255 F. 2d 706.

JURISDICTION

The judgment of the Court of Appeals was entered on June 2, 1958. (Pet. 38.) The petition for a writ of certiorari was filed on August 25, 1958. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether a levy made upon a taxpayer's debtor under Section 6332 of the Internal Revenue Code of 1954, prior to insolvency, is effective to appropriate the debt to the United States and thereby establish a

priority of right in the Government to satisfaction which is unaffected by the debtor's subsequent insolvency.

2. Alternatively, whether the levy at least accomplished an assignment of taxpayer's claim against the debtor to the United States, by operation of law, whereby the obligation became, as of the date of the levy, a debt "due to the United States" within the meaning of Revised Statutes, Section 3466, entitling the United States to priority of payment.

STATUTES INVOLVED

Sections 6331 and 6332 of the Internal Revenue Code of 1954, and Revised Statutes, Section 3466, are set forth in Appendix, *infra*, pp. 10-12.

STATEMENT

The facts as they appear in the certificate of review filed by the Referee (Pet. 20-29) are as follows:

The debtor, Cherry Valley Homes, Inc., is one of several closely affiliated corporations engaged in the construction of residential dwellings and the development of real estate. On May 28, 1957, it filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. Three of the affiliates—namely, Anchorage Construction Company, Cherry Valley Builders, Inc., and Delaware Valley Builders, Inc.—were mere straw corporations working for the benefit of the debtor, and their debts are the debts of the corporation in reorganization. Prior to the inception of the reorganization proceedings, these three affiliates were indebted to the taxpayer, M. Tobin Company, Inc., in the total amount of $7,473.50 as follows: Anchorage Construction Company, $1,139; Cherry Valley Builders,

Inc., $3,720.50; and Delaware Valley Builders, Inc., $2,614.

The M. Tobin Company, Inc., is indebted to the United States for various tax claims (unpaid withholding and employment taxes for the first and second quarters of 1956) in a sum in excess of $8,000. No part of those taxes has been paid. On December 3, 1956, the District Director of Internal Revenue for Philadelphia levied upon the three affiliates demanding payment of any sums they owed the taxpayer as partial satisfaction of the tax liability. Nothing having been paid pursuant to those levies, the District Director, on or about August 30, 1957, filed proof of claim for those taxes in the reorganization proceeding and demanded priority of payment thereof. The claim was addressed against the debtor corporation and its three affiliates.

The Referee refused to allow the priority of this claim and ruled that the United States would be limited to the amount which the taxpayer would be entitled to as an unsecured general creditor. The District Court sustained the decision of the Referee, but the Court of Appeals unanimously reversed the judgment of the District Court.

ARGUMENT

The court below held that (Pet. 36), "[i]n legal contemplation and consequence", the levy effected by the District Director of Internal Revenue upon the taxpayer's debtor, Cherry Valley Homes, Inc., six months prior to the time the debtor filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act, "effectively and exclusively appropriated the debt to the satisfaction of the tax claim" of the United States, and was clearly sufficient to establish a priority

of right to satisfaction which the debtor's subsequent insolvency did not effect. Alternatively, the court held (Pet. 36-37) that, in any event, the tax levy at least accomplished an assignment of the taxpayer's claim against the debtor to the United States by operation of law, and that this approach brought into decisive effect Section 3466 of the Revised Statutes (Appendix, *infra*, pp. 11-12), which provides that "whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied."

Both of these alternative holdings are correct, and the correctness of either would require that the judgment below be sustained. In addition, there is no conflict of decisions, nor any other reason warranting review by this Court.

1. The court's primary holding—that the levy appropriated the debt to the satisfaction of the tax claim—finds support in *United States* v. *Eiland*, 223 F. 2d 118 (C.A. 4th), which is directly in point. It is also supported by *United States* v. *Metropolitan Life Insurance Co.*, 256 F. 2d 17 (C.A. 4th), and *Kyle* v. *McGuirk*, 82 F. 2d 212 (C.A. 3d), and is in accord with *Freeman* v. *Mayer*, 253 F. 2d 295 (C.A. 3d), and *Givan* v. *Cripe*, 187 F. 2d 225 (C.A. 7th).

In the *Eiland* case, *supra*, the facts were in material respect substantially the same as here. There, a District Director of Internal Revenue levied upon an indebtedness owing to a taxpayer-bankrupt three days prior to the institution of bankruptcy proceedings. The debtor accepted service of the notice of levy and demand. After the adjudication of bankruptcy, it paid the sum levied upon to the trustee in bankruptcy pursuant to an order of the Referee. As in the instant case, the

United States claimed a lien on the property right for satisfaction of the taxes for which its levy and demand were made. Pointing out that a lien for taxes can be asserted against intangible property such as a debt, and that the proper way to assert the lien is by notice and levy, the Fourth Circuit held that, by levying upon the account receivable prior to the bankruptcy of the taxpayer, the Government thereby took possession of the indebtedness, so that the Government's lien claim was not postponed to the administration and wages claims for which priority was asserted under Section 67c of the Bankruptcy Act.[1] In its opinion, the Fourth Circuit stated that the effect of the levy was to transfer the creditor's right to receive payment to the United States. In this regard, it pointed out (p. 121) that when, as in the instant case, bankruptcy occurs *after* the levy and notice have been served upon a debtor of the bankrupt, the trustee in bankruptcy cannot interfere with the rights of the United States thereby perfected before bankruptcy.

Although the other cases cited above did not involve bankruptcy proceedings, they do, in legal effect, stand for the proposition that levy upon an indebtedness owed a taxpayer by a third party amounts to a seizure by the United States of the taxpayer's property rights in that debt.[2] Thus, in the *Metropolitan* and *McGuirk* cases, *supra*, it was held that an insured's interest in life insurance policies was subjected to tax liens of the

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[1] C. 541, 30 Stat. 544, 564 (11 U.S.C. 1952 ed., Sec. 107c).

[2] In *United States* v. *Liverpool & London Ins. Co.*, 348 U.S. 215, where it was held that tax liens of the United States were superior to the lien of a garnishee, notice of the tax lien with warrants of distraint and notice of levy had been served upon a debtor of its insurance company.

United States by levy effected pursuant to the provisions of the Internal Revenue Code.[3]

The holdings in *Freeman* v. *Mayer, supra*, and *Givan* v. *Cripe, supra*, are in complete and full accord with the *Eiland* holding (*supra*) and the decision below. The principle of those cases is that a levy is not effected by mere service of notice upon the debtor, nor in the absence of steps sufficient to appropriate the indebtedness levied upon and to establish the tax lien as one accompanied by possession. As the court below pointed out (Pet. 36), however, there is no suggestion in the instant case that the notice to and demand upon the debtor, Cherry Valley Homes, Inc., was in any way inadequate as a levy upon a debt it owed the taxpayer, and consequently that "On the record we have a perfected levy upon specific incorporeal property of a taxpayer, namely, a liquidated sum owed Tobin by Cherry Valley". Since that levy was perfected prior to the insolvency of the taxpayer's debtor, the previously existing tax lien of the United States was thereby transformed into a lien accompanied by possession of the indebtedness levied upon, which, as the court below held, was "clearly sufficient to establish a priority of right to satisfaction which the debtor's subsequent insolvency does not affect". In this posture of the case, no question of priorities under Section 3466 of the Revised Statutes is involved.

2. As an independent alternative basis for its decision, the court below held that the tax levy, through process served upon the debtor, at least accomplished an assignment of the taxpayer's claim against his debtor

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[3] The recent decision of this Court in *United States* v. *Bess*, 357 U.S. 51, does not affect this principle.

to the United States by operation of law which served to bring into effective operation the priority provisions of Section 3466 of the Revised Statutes.

This holding is supported by the decisions in *Wagner v. McDonald*, 96 F. 2d 273 (C.A. 8th), and *Korman v. Federal Housing Administrator*, 113 F. 2d 743 (C.A. D.C.). In those cases, the United States was an assignee prior to bankruptcy of a debt owed to a private creditor. In both cases, the courts rejected a contention, such as advanced here by the trustee (Pet. 13-16), that the rights of the United States did not extend beyond those of the taxpayer in the property assigned. Those courts pointed out that priority under Section 3466 did not depend upon how the United States acquired title to the property assigned, nor upon the status of the parties or the character of the obligation prior to the assignment. Rather, as pointed out in the *Wagner* case, *supra*, p. 275, "Priority is the result of insolvency of the debtor and ownership of the claim by the United States." See also *Beaston v. Farmers' Bank*, 12 Pet. 102, 134.

The cases[4] cited by the trustee (Pet. 14-16) in support of his contention that the taxpayer was merely a general creditor of Cherry Valley Homes, Inc., and, hence, that the United States could not acquire any greater rights than taxpayer had in the property levied upon, do not affect the holdings here. Those cases were merely concerned with whether or not the debtor against whom the tax lien of the United States was sought to

[4] *United States v. Winnett*, 165 F. 2d 149 (C.A. 9th); *Karno-Smith Co. v. Maloney*, 112 F. 2d 690 (C.A. 3d); *F. H. McGraw & Co. v. Sherman Plastering Co.*, 60 F. Supp. 504 (Conn.), affirmed, 149 F. 2d 301 (C.A. 2d), certiorari denied, 326 U.S. 753; and *Bankers Title and Abstract Co. v. Ferber Co.*, 15 N.J. 433.

be enforced had any property or property rights belonging to the tax delinquent creditor, and, if so, the amount thereof subject to the lien or levy. No such problems are presented herein for the facts show that the bankrupt was clearly indebted to the taxpayer in a liquidated amount prior to the inception of reorganization proceedings under Chapter X of the Bankruptcy Act. It is clear, moreover, that such indebtedness constituted "property or rights to property" subject to levy and distraint within the meaning of Sections 6331 and 6332 of the Internal Revenue Code of 1954 (Appendix, *infra*, pp. 10-11).[5]

3. The trustee's further contentions (Pet. 12-13, 17-18) that the decision below "violates public policy" and will have "widespread harmful effects on the interests of both the Federal Government and citizens" are also without merit for the reasons stated above. These contentions seem to be based upon the trustee's assertions (Pet. 12, 18) that there is no evidence of record that the taxpayer (Tobin) was insolvent and consequently that it would be "unfair and inequitable" for the United States to collect the amount due it from the taxpayer at the expense of the general creditors of the bankrupt without first exhausting the possibility of collecting its taxes from other assets of the taxpayer. However, as the court below pointed out (Pet. 37), there is no inequity in recognizing that the Government acquired a priority over general creditors when its claim was asserted and perfected against the debt owed by the bank-

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[5] See *United States* v. *Eland*, *supra*; *United States* v. *Metropolitan Life Insurance Co.*, *supra*; *United States* v. *Long Island Drug Co.*, 115 F. 2d 983 (C.A. 2d), and see also *Glass City Bank* v. *United States*, 326 U.S. 265; *Citizens State Bank of Barstow, Tex.* v. *Vidal*, 114 F. 2d 380, 382-383 (C.A. 10th); *Martens* v. *United States*, 245 F. 2d 135, 137 (C.A. 10th).

rupt many months before Chapter X proceedings were instituted. It added (Pet. 37) that to make the argument of inequity even colorable it would have to appear that the bankrupt (Cherry Valley Homes, Inc.) was insolvent when the levy was made upon the debt it owed, but that the record discloses no such fact.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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SEPTEMBER 1958.

APPENDIX

Internal Revenue Code of 1954:

SEC. 6331. LEVY AND DISTRAINT.

(a) *Authority of Secretary or Delegate.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d) of such officer, employee, or elected official. If the Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

(b) *Seizure and Sale of Property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such prop-

erty or rights to property (whether real or personal, tangible or intangible).

* * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 6331.)

SEC. 6332. SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) *Requirement.*—Any person in possession (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for Violation.*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy.

* * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 6332.)

Revised Statutes:

Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due

from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(31 U.S.C. 1952 ed., Sec. 191.)

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